NZ GDP: Q2 2022 Review

15 September 2022

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Contact

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Stronger, but more noise than signal

Bottom line

- The New Zealand economy expanded 1.7% in Q2, much stronger than our expectation for a 0.4% rise, stronger than the median analyst expectation of 1.0%, and just a touch below the RBNZ's August MPS forecast of 1.8%.
- This was a tricky quarter to forecast given a lot of noisy moving parts: lingering Omicron disruption, resource scarcity (particularly labour); quirky seasonality, loosening border restrictions; the end of domestic petrol refining; the impact of rising interest rates; and ongoing COVID-induced measurement difficulties. In the end, all of the above netted out as stronger growth than expected, but this noise lowers the bar for weaker quarterly growth as we head into summer.
- Perhaps the real "story" in these data is that there isn't much of a story – at least so far as the OCR is concerned. The GDP data are still noisy, and ongoing wage and CPI inflation pressures, combined with fiscal expansion, means the RBNZ's back is against the wall. They will be hiking the OCR to at least 4% by the end of the year no matter where activity lands (assuming no significant negative employment shock).

The big picture

Economic activity expanded 1.7% q/q in Q2, above our weaker-than-consensus expectation of 0.4%, and the median analyst forecast of 1.0%. And while it might be tempting to put a better "momentum" story around these data, it's important to note that the Q2 GDP data was going to have to really be one out of the box before it was likely to become meaningful for the RBNZ's monetary tightening strategy. And with growth so close to the RBNZ's 1.8% forecast, this result is firmly in the box. But in essence, regardless of the activity data, wage and CPI inflation pressures are simply too high for the RBNZ not to carry on with OCR hikes to at least 4%.

Indeed, with economic resource all but tapped out (particularly labour), we think it's much more likely that activity outturns are currently more reflective of the ups and downs of supply capacity and quirky seasonal factors, as opposed to telling us much about the underlying state of demand. In short, resources still look very stretched, meaning broad economic conditions are still far too inflationary for the RBNZ to get hung up on noisy GDP data.

Flowing these data through to our medium-term forecast should be a relatively mechanical exercise. Growth may have been stronger than expected, but given softening domestic momentum (on the back of rising interest rates), seasonal adjustment noise, and the very elevated starting point, it's hard to conclude that the strong Q2 read is anything more than blip. Unless we see a miraculous supply-side recovery, the RBNZ still needs to dampen demand with a higher OCR in order to take the heat out of inflation. It's not really a question of whether or not economic headwinds will build, it's a question of how high the OCR needs to go to make those headwinds sufficiently strong to reduce inflation pressures. If wage growth keeps up its recent pace, the OCR peak will likely need to be higher than the 4% peak we're forecasting.

Data summary

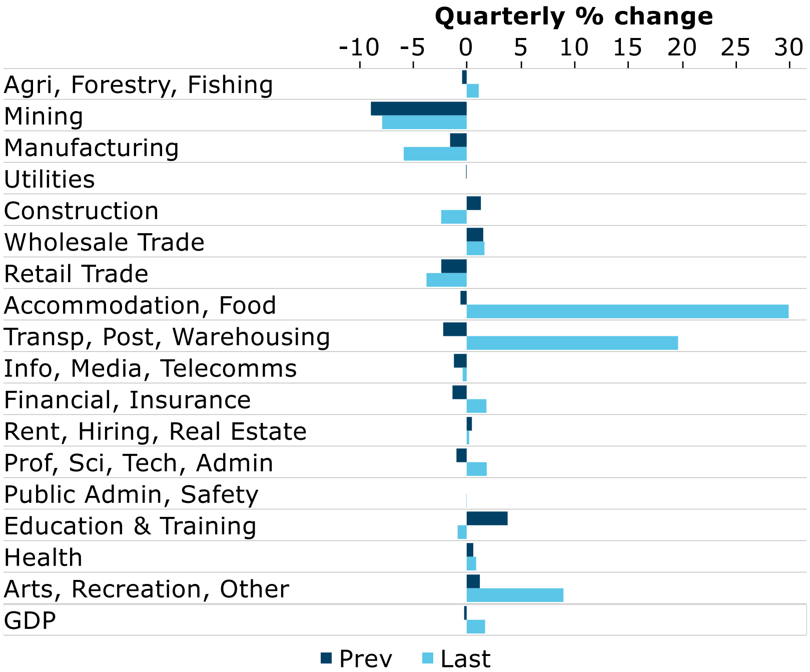
	Latest	Prev
Quarterly % change	1.7%	-0.2%
Annual % change	0.4%	1.2%
Annual average % change	1.0%	5.0%

The details

Turning to the details, the biggest surprise relative to our pick came from retail trade and accommodation (up 5.9% q/q, with the accommodation and food services component up 30% q/q and the rest of retail down 3.7%), and transport (up 19.7%). Together, these components added 1.1% points to quarterly growth. Arts, Recreation and Culture was also strong at 9.0% q/q. All up, this simply looks like more quirky seasonality playing out than we factored in. And that suggests the bar for some payback over coming quarters is low, particularly if the reopening border doesn't drive a swift recovery in travel-related industries.

The weaker spots at the industry level were manufacturing (down 5.9%) and construction (down 2.4%). The latter was a bit of a surprise, given the positive signal we had from building work put in place, but construction is lumpy, meaning there should be a bounce in Q3. Weaker manufacturing was well signalled in the manufacturing survey, with the end of petroleum refining weighing. The reclassification to wholesale trade looks to have given wholesale a smaller bump than the pre-GDP data suggested, but this was always a risk.

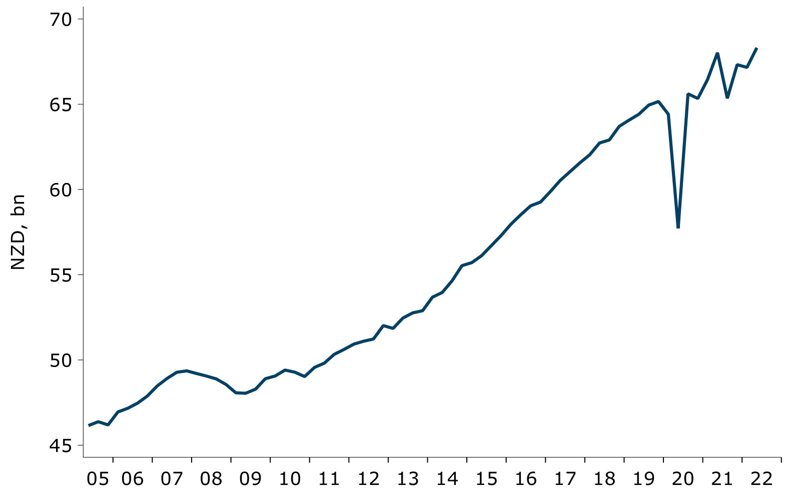
Figure 1. Quarterly change in GDP by industry



Source: Stats NZ, Macrobond, ANZ Research

In year-on year terms, growth came in at 0.4%, and in annual average terms at 1.0%. However, with past lockdown-induced volatility yet to wash out of the annual growth measures, we're not paying these metrics much attention. Eyeballing the level of GDP shows just how volatile the data have been over the past couple of years.

Figure 2. Production GDP

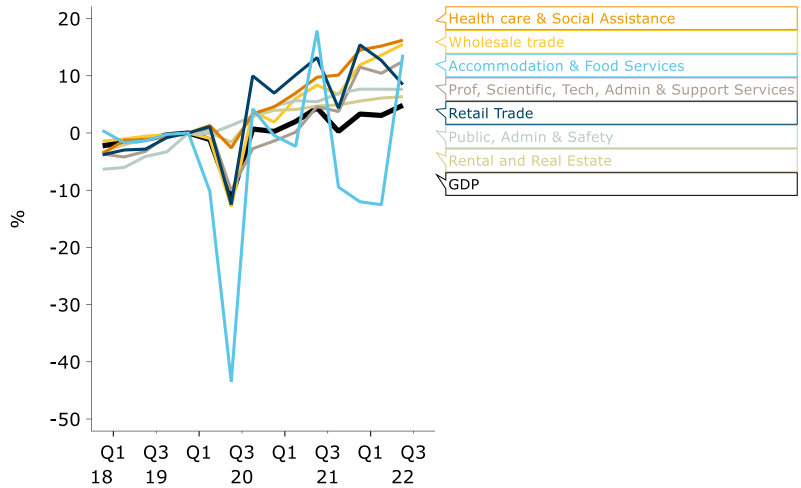


Source: Stats NZ, Macrobond, ANZ Research

Indeed, with this much volatility in the data we're probably better off looking at the post-COVID evolution in level terms rather than getting too caught up in the quarterly and annual growth figures. Figures 3 and 4 show which industries were outperforming and which were underperforming general activity in Q2. By presenting the change relative to Q4 2019 as a time series we can get a feel for which industries have been doing it tough, and which have been going gangbusters.

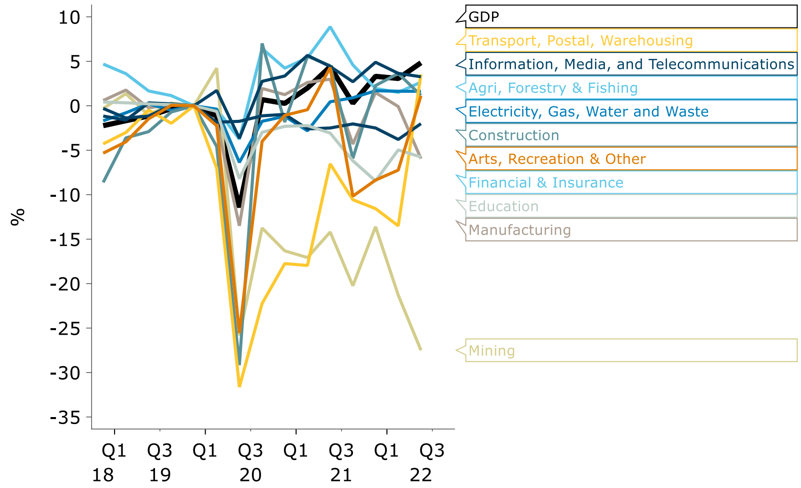
Broadly, it's been a case of the industries more dependent on foot traffic and international travel doing it tough, and the industries benefiting from the very sizable macroeconomic stimulus over the past couple of years having a better time of it. Looking forward (and looking through the quirky seasonal impacts that have bolstered growth in Accommodation and Food Services, Transport, and Arts and Recreation in Q2), we suspect this wonkiness will even out over the coming year or so. Higher interest rates will weigh on domestic demand, as the border reopening sees travel-dependent industries recover. But picking quarter-on-quarter growth rates as this unravels and other COVID issues continue to wash out will remain a big challenge. This noisy data streak isn't over!

Figure 3. Outperforming industries in Q2 2022 (change since Q4 2019)



Source: Stats NZ, Macrobond, ANZ Research

Figure 4. Underperforming industries in Q2 2022 (change since Q4 2019)



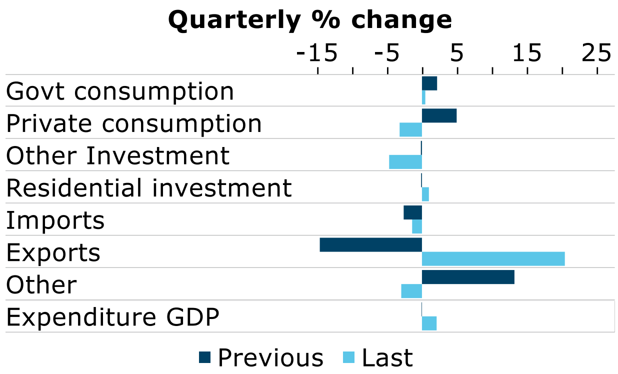
Source: Stats NZ, Macrobond, ANZ Research

The seasonally adjusted expenditure GDP measure is definitely navigating a volatile patch. This measure lifted 2.1% q/q as services exports rebounded 60.7% from Q1's 25.8% decline. This might sound impressive, but it's largely seasonal adjustment noise. Likewise, the 3.1% decline in private consumption following Q1's 5% rise is mostly wonky seasonal messiness. That said, the 8.6% q/q fall in durables consumption is the first place you'd expect to see the impacts of squeezed household balance sheets. Broadly, however, it's hard to say this represents a sharp turning point in household spending momentum (which tends to account for more than 60% of GDP), as the data are just too noisy.

Central government consumption grew 0.5% q/q, with local government up 1.6%. The former has plenty of scope to carry on at a high pace over the year ahead, given fiscal settings. But whether this fully makes its way to real activity (given capacity limits) is an open question.

Investment had a weaker quarter, with gross fixed capital formation down 3.1% q/q. That was led by a 28.5% fall in transport equipment, which has been very volatile of late.

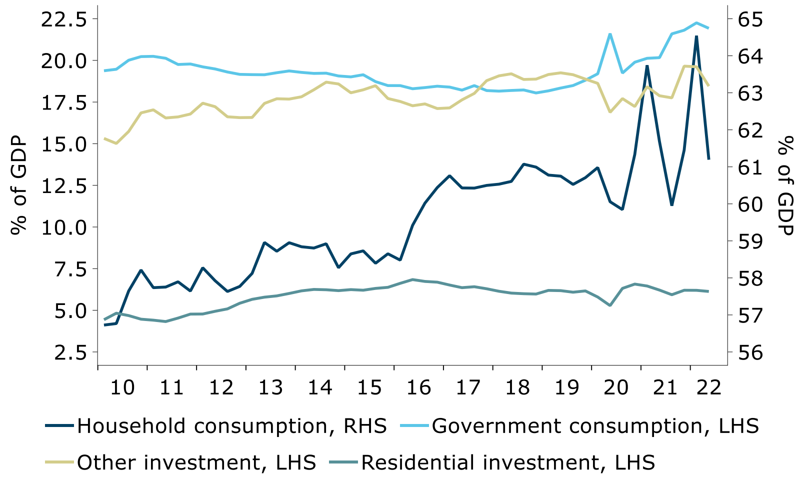
Figure 5. Expenditure GDP growth



Source: Stats NZ, Macrobond, ANZ Research

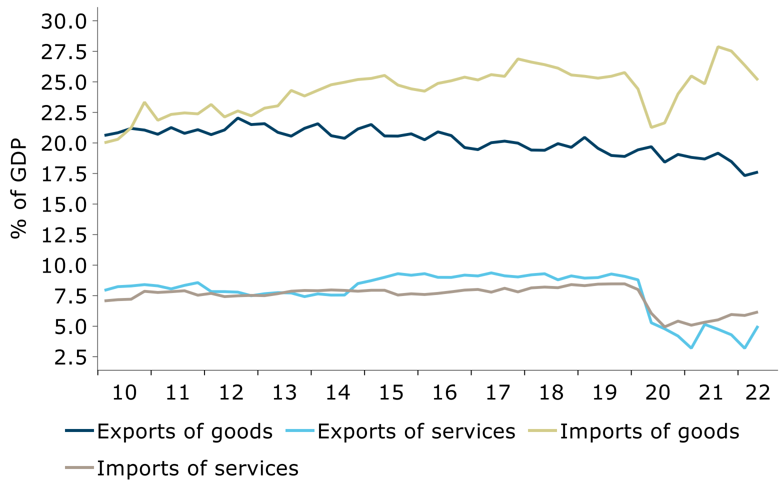
Overall, the post-pandemic story is pretty clear in the expenditure GDP data. Exports have taken a big hit thanks to the closed border and missing international tourists and students, but significant macroeconomic stimulus (fiscal and monetary) has seen domestic demand fill that hole (broadly, and in aggregate terms). Figure 6 and 7 show the key expenditure components of GDP as a share of total GDP. Domestic and goods imports shares have been trending higher, while exports (particularly services) struggle, and seasonal adjustments have made this very messy on a quarter-to-quarter basis. But this broad composition story is poised to change over the coming year, with big question marks remaining around whether the net exports recovery will be large enough for New Zealand to avoid a domestic demand-driven recession in 2023.

Figure 6. Domestic components share of total



Source: Stats NZ, Macrobond, ANZ Research

Figure 7. External sector components share of total



Source: Stats NZ, Macrobond, ANZ Research

In sum, the data are still very noisy, and Q2 doesn't look like it's a game changer for our medium-term forecast or the OCR.

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